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Disaster and Business Interruption Coverages in the Wake of Hurricane Irene & Tropical Storm Lee

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Publication Date: October 19, 2011

Although some "high-profile" targets like downtown Manhattan and Washington, D.C. largely avoided Hurricane Irene's wrath, Irene still left a swath of major damage and destruction over a massive geographic area of New England, Mid-Atlantic and Southeastern states. Coupled with the heavy rains brought by Tropical Storm Lee shortly after, the impact of these storms has been truly catastrophic to many. As with the 2005 hurricanes in the Gulf of Mexico, Hurricane Irene and Tropical Storm Lee will spawn many commercial insurance claims, and many of the claims will be Business Income (or Business Interruption) claims, seeking to recover lost profits arising from property damage or other commercial dislocations. And like claims stemming from previous mass catastrophes, many of these claims - especially the large ones - will be strenuously resisted by insurance companies.

What follows is a short outline and summary of the coverage issues that can arise in Business Income insurance claims. The goal of this brief overview is to highlight some of the coverages that may apply to losses stemming from Hurricane Irene and Tropical Storm Lee so commercial policyholders can properly preserve and maximize their insurance for such losses.

A. Business Income (or Business Interruption) Insurance

Business Income insurance is designed to cover a policyholder for profits lost, and unavoidable expenses incurred, during the Period of Restoration needed to repair or replace damaged or destroyed property used by the policyholder in its operations.

The first coverage issue is the most fundamental: figuring the rate at which Business Income is lost during the Period of Restoration. Most policies provide little guidance as to how the amount of a Business Income loss is calculated: essentially, they state that Business Income is calculated from historical figures. This leads to many sources of potential conflict, for instance:

- What amount of historical data is looked at? The previous month? The previous year? The answer: this depends on the type of business. For instance, seasonal businesses can establish loss through reference to previous seasons. In general, experience from the previous few years, along with projections for the Period of Restoration, may be used to establish loss.
- What about new or unprofitable businesses? The answer: both types of businesses are permitted to attempt to establish that they would have enjoyed profits in the Period of Restoration. Further, unprofitable businesses are allowed to recover continuing expenses to the extent that revenues

would have been sufficient to cover them. Second, an insurance company may argue that, to the extent the policyholder's operations are not completely shut down, there has been no "interruption." Although insurers have had some success with this argument, it misconceives the purpose of Business Income insurance, which is designed to do for the policyholder what it would have done had there been no damage. When damage impacts operations, the resulting loss is covered, regardless of whether operations totally shut down.

Third, issues typically arise regarding the length of the Period of Restoration, during which the loss of Business Income is covered. As normally written, this period is limited to the shorter of (i) the hypothetical time in which the destroyed property could be repaired, rebuilt or replaced "with due diligence and dispatch" or "reasonable speed," or (ii) the actual time it takes to repair, rebuild or replace the property. A number of issues can arise surrounding the former, "hypothetical" date. For instance, does it start during the period when authorities will not let the policyholder on site? Alternatively, is the Period of Restoration extended to account for the insurance company's delay in adjusting a claim? In general, delays occasioned by events out of the policyholder's control will serve to extend the Period of Restoration. Accordingly, if the insurance company delays in providing the policyholder sufficient money to get back into business, this delay will extend the Period of Restoration.

Fourth, insurance companies - as they did after the 2005 Gulf hurricanes - may seek to take advantage of the wider effects of the catastrophe, by arguing that Business Income recoveries of particular policyholders must be slashed because the widespread damage decreased customer demand. At its core, however, Business Income insurance is unlike most other insurance in that it is based on assumptions contrary to fact: it aims to do for the policyholder what the policyholder would have done **had there been no catastrophe**. Accordingly, in the absence of express policy language permitting consideration of the wider effects of the loss, insurers should not be permitted to use those effects to **decrease** recovery. On the other hand, some courts have allowed the policyholder to receive the benefit of projected increased sales it could have generated following a catastrophe, absent express policy language precluding that approach.

B. Other Business Income Coverages

In addition to coverage for losses of Business Income stemming from the destruction of the policyholder's own property, a number of other coverages are available for losses of Business Income resulting from other events:

- ***Contingent Business Income*** coverage is designed to cover a policyholder for loss of income caused by damage to or destruction of property owned by others, usually identified as "contributing" or "recipient" locations (e.g., suppliers and customers). An example would be coverage purchased by a car maker to protect it if its sole supplier of a key component suffers destruction of its factory, and the car maker suffers a Business Income loss from its inability to complete the manufacture of cars. Coverage under these provisions varies widely, with some provisions limiting coverage to "direct" customers or suppliers, and other provisions covering customers or suppliers "of any tier" (e.g., customers of customers). For most policies, one Period of Restoration definition controls evaluation of both Business Income and Contingent Business Income losses, but problems may arise because neither policyholder nor insurance company can monitor the "due diligence" of the third party. A policyholder should resist any argument that the Period of Restoration ends if the policyholder secures an alternative supplier or customer if any portion of the loss continues; in other words, although obtaining an alternative supplier can mitigate the loss, it does not end the period in which loss is measured.

- ***Contingent Extra Expense*** coverage is designed to pay for increased costs incurred after the disaster to minimize or avoid a Contingent Business Income loss. Accordingly, if a business incurred additional expenses to avoid or minimize a Contingent Business Income loss, it may have coverage for those costs under Contingent Extra Expense coverage.
- ***Service Interruption*** coverage is designed to provide coverage for Business Income losses attributable to dislocation of utility or telecommunications service.
- ***Ingress/Egress*** coverage is designed to pay for the loss of Business Income caused by physical loss or damage to third-party property that prevents or hinders ingress to or egress from the policyholder's business.

Note that it is not unusual for a policyholder to have rights under multiple coverage provisions, each of which may have separate limits. The policyholder should be entitled to order its claim under these provisions to maximize recovery. For instance, if the policyholder has both a Business Income loss (capped by a 12-month maximum Period of Restoration) and a Contingent Business Income loss (capped by a $1 million sublimit), it should be able to recover Business Income for the first year and then an uneroded Contingent Business Income limit the next year.

C. Conclusion

For those affected by Hurricane Irene and Tropical Storm Lee, insurance coverage will be crucial to recovery. However, insurance coverage can be voided if a policyholder does not give timely notice of its losses, file proofs of loss within specified time periods, or file suit on disputed claims within the timeframe required by the policy or by law. Policyholders who have suffered damage and/or business interruption as a result of Hurricane Irene or Tropical Storm Lee (or both) should review their first-party coverages and give appropriate notice of potentially covered losses, so that they can pursue and maximize the coverage to which they are entitled.

Reed Smith's Insurance Recovery Group has extensive experience advising and assisting policyholders in all aspects of first-party property damage and Business Income insurance claims. Our Insurance Recovery Group members successfully have represented policyholders on insurance claims from catastrophic events ranging from the 9/11 terrorist attacks to Hurricane Katrina to the Sendai earthquake and tsunami in Japan.

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